

STATE OF WASHINGTON



**OFFICE OF
INSURANCE COMMISSIONER**

REPORT OF

TARGET MARKET CONDUCT EXAMINATION

OF

NORTHWESTERN MUTUAL LIFE INSURANCE COMPANY

MILWAUKEE, WISCONSIN

AS OF

DECEMBER 31, 1996

January 28, 2000

The Honorable Deborah Senn
Washington Insurance Commissioner
Olympia, Washington 98504

Dear Commissioner Senn:

Pursuant to your instructions and in compliance with the statutory requirements of RCW 48.03.010, I have examined the corporate affairs and market conduct of:

Northwestern Mutual Life Insurance Company

Milwaukee, Wisconsin

hereafter referred to as "the Company" or "NML". The following report is respectfully submitted.

Scope of Examination

The examination was performed in compliance with the provisions of Washington insurance laws and regulations. The market conduct review followed the rules and procedures promulgated by the Office of the Insurance Commissioner (OIC) and the National Association of Insurance Commissioners (NAIC). The examination covered the period of January 1, 1992 through December 31, 1996. The scope of this examination was limited to Marketing and Sales Practices, Complaint Handling and Replacement Activity.

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EXAMINATION REPORT CERTIFICATION

This examination was conducted in accordance with the Office of the Insurance Commissioner and National Association of Insurance Commissioners market conduct examination procedures. This examination was performed by Leslie Krier and Alan A. Hudina, who participated in the preparation of this report.

I certify that the foregoing is the report of the examination, that I have reviewed this report in conjunction with pertinent examination work papers, that this report meets the provisions for such reports prescribed by the Office of the Insurance Commissioner, and that this report is true and correct to the best of my knowledge and belief.

Pamela Martin

Chief Market Conduct Examiner

Office of the Insurance Commissioner

State of Washington

FOREWORD

This target market conduct examination report is by exception and additional practices, procedures and files subject to review during the examination were omitted from the report if no improprieties were indicated. Throughout the report, where cited, RCW refers to the Revised Code of Washington and WAC refers to the Washington Administrative Code.

SCOPE

Situs

This examination was a Level Two Target Market Conduct Examination conducted at the Office of the Insurance Commissioner in Seattle, Washington.

Time Frame

The examination covered the company's operations for the period January 1, 1992 through December 31, 1996.

Methodology

Sampling Standards: In general the sample for each test utilized in this examination falls within the following guidelines:

92% Confidence Level

+/- 5% Tolerance

Regulatory Standards: Company records are tested for compliance with standards established by the OIC. The tests applied to sampled data will result in an error ratio, which determines whether or not a standard is met. Generally, if the error ratio found in the sample is less than 5%, the company will be considered as meeting the standard. The standard for agent licensing and appointments has a "Zero Tolerance" level. If there are any violations of this standard, the company will not meet the standard. The same tolerance levels will be applied if the records examined are a sample of the total population or the entire population.

For those standards concerning the existence of written procedures or a processes, the decision of a standard being met or not met will be based on the examiner's analysis of those procedures or processes.

History of the Company

Territory of Operations

Management

Northwestern Mutual Life Insurance Company (NML) was admitted to the State of Washington on December 8, 1890. NML was originally incorporated as Mutual Life Insurance Company of Wisconsin in March 1857. Its present title was adopted in 1865.

NML is licensed for life and disability insurance in Washington and has authority for annuity products. The Company's taxable premium volume in 1996 in Washington was \$70,830,164. Nationally, as of the examination date, the Company had approximately 5600 agents working in 103 independently managed general agencies.

A Board of Trustees governs the Company. The members are:

R. Quintus Anderson	Edward E. Barr
Gordon T. Beaham III	Robert C. Buchanan
Robert E. Carlson	George A. Dickerman
Pierre S. DuPont	James D. Ericson
J. E. Gallegos	Stephen N. Graff
Patricia Albjerg Graham	Stephen F. Keller
Barbara A. King	J. Thomas Lewis
Daniel F. McKeithan, Jr.	Guy A. Osborn
Timothy D. Proctor	Donald J. Schuenke
H. Mason Sizemore, Jr.	Harold B. Smith
Sherwood H. Smith, Jr.	John E. Steuri
John J. Stollenwerk	Barry L. Williams
Kathryn D. Wriston	

For operations in the State of Washington, the Company's records are located at Northwestern Mutual Life's Home Office in Milwaukee, Wisconsin. Policy record files are stored on film. Original records are stored off site at the Records Center for 2½ years at which time they are destroyed. Film is retained indefinitely.

Mainframe processing of policy administration records occurs on an Amdahl GS-735 machine using the OS/390 operating system. Contract administration is done via in house developed software. The mainframe is located at NML's home office in Milwaukee, Wisconsin.

Affiliates and Subsidiary Companies

There are 96 subsidiary companies on the listing provided by NML. None of these companies are considered relevant to the subject of this examination.

Marketing Plan

The Company provided marketing plans for the exam period as requested. A review of these plans revealed the following information:

- 1992 – The main area of focus was the integration and implementation of new products into the Company portfolio and systems to support both new and existing products.
- 1993 – Outlined under the heading "Develop new marketing initiatives" was a term conversion program. This program provided for conversions of existing term insurance to permanent plans. As this was a contractual change and exempt from replacement regulations, we did not gather additional information on this program.
- 1994 – This years plan contained numerous references to market penetration and agent support.
- 1995 – This plan refers to the need to "respond to the sales practices 'crisis' by enhancing our ability to provide additional sales material to the field." The Company was asked for additional specifics on their actions in this regard and responded that they increased home office created sales material, reviewed and revised existing sales material, improved the approval process for agent created material by shortening the approval or rejection time for material and by providing agents with increased assistance on developing material.
- 1996 – The 1993 term conversion program was mentioned in the context of seeking recommendations and implementation of "improvements in our term conversion program aimed at increasing the total number of contracts converted each year." It should be noted that this program encompasses both credits for the insured and commission adjustments for the agents.

On September 1, 1987, the Company initiated The Fresh Start Program in response to the Tax Reform Act of 1986. The program was operational during the time period of the examination. The program was designed to assist policyholders in dealing with tax law changes that phased out the tax advantages of paying interest on personal loans. For policyholders with a policy loan, the program allowed for three possible options – retaining the loan, repaying the loan or changing the policy to an Inforce CompLife Plan, which was considered a 1035 Exchange. Production and commission credits were adjusted. While this program did involve replacements and exchanges of policies, it was borne out of tax law changes. It was an effort to assist the policyholder and to retain contracts as opposed to a marketing program whose intent was churning policies for the Company's or agent's benefit and to the policyholder's detriment.

STANDARD 1 – The marketing plan does not contain references to vanishing premium policies, replacement programs, exchange programs or other indicators of possible churning activities.

RESULT – The Company meets this standard.

Advertising File/Illustration Diskettes

Advertising

The Company's advertising file was reviewed pursuant to WAC 284-23-090. Items were selected for review based upon their perceived relevance to the scope of the examination. The advertising file contained copies of all advertising materials as defined in WAC 284-23-090. Numerous materials, both for agent use only and those for public dissemination were reviewed. The Company conducts regular audits of its general agencies which include a review of advertising material, illustrations and client files.

STANDARD 2 – All agent or vendor produced training materials are controlled by the Company and that the Company actively audits use of these materials.

RESULT: The Company meets this standard.

Illustrations

Numerous illustrations were run and reviewed. No two tiered nor bonus interest situations were encountered. There were adequate disclaimers relative to projected and illustrative values and the guaranteed versus projected values were adequately identified.

After running numerous illustrations, the following observations are noted:

- Changing the interest rate requires a password. Various words were tried without gaining access.
- The edit fields only allowed changes of name, address, plan etc. No other parts of the illustration could be changed.
- Input of interest rates outside of the allowed rate for the plan are not accepted. Interest rates below the allowed rate for the plan are not accepted.
- Accessing the print command for the illustration and then returning to edit and inputting a higher interest rate is not allowed.

STANDARD 3 – The advertising file contains copies of all advertising materials as statutorily defined, including copies of agent created advertising materials, WAC 284-23-090 and WAC 284-23-020.

RESULT: The Company meets this standard.

The Company has advertising guidelines in place and communicated to field personnel through the New Agents Kit. The "Compliance and Sales Practices Newsletter" as well as detailed sections of their Agents Manual of Information (AMI) also state the Company position concerning use of advertising materials. The Company also produces a number of brochures addressing advertising material used by agents. These are: "NML Field Management Business Conduct Guidelines", "The Responsibilities of Being a NML Agent", "The Responsibilities of Being a NML Life Associate Agent and Agents Assistant" and "The Assistants Guide to Quality Business Practices". The procedures and guidelines were examined and found to be consistent with the regulations.

STANDARD 4 – Advertising materials comply with Washington Advertising Regulations, WAC 284-23-010 through WAC 284-34-080.

Number of advertisements	848
Number of Advertisements reviewed	46
Number in violation	0
Percent in violation	0 (within 5% tolerance)

RESULT: The Company meets this standard.

Agent Activity

Agent Marketing and Training Bulletins

The Company provided marketing, training and procedural documentation. This documentation included video and audio tapes, a CD of their procedures and a "New Agents Kit". The kit contained four binders entitled "Product Descriptions and Rates," "The Essentials of Life Underwriting," "Individual Disability Insurance," and "The Essentials of Disability Insurance Underwriting". Four diskettes covering the same materials are included with the kit. There were five manuals entitled "Policy Changes and Service," "Policy Benefits and Claims," "New Policy Plans," "Directory of Information," and "General Business Information". These were also directed at agent training. There were numerous other pamphlets and brochures included as well.

STANDARD 5 – Agent communications do not encourage replacement of existing internal or external policies, special funding programs or other indicators of churning activity.

RESULT: The Company meets this standard.

Audits

Consistent with Company policy, agency audits were conducted by the Company on agencies operating in Washington. These audits consisted of a review of advertising materials, illustrations and client files. There were no significant findings relative to the scope of this examination in any of these audits.

STANDARD 6 – Company conducts regular audits of agent activities through regular branch or agency office audits and visits.

RESULT: The Company meets this standard.

Agent Training Materials

The Company maintains an on-going agent education program. In April 1995, the Company began distributing a quarterly newsletter, "Compliance and Sales Practices Newsletter" to its field management. In 1996, the newsletter was distributed to all NML Agents. The Company also sponsors numerous state approved courses for agent continuing education.

Random editions of the "Compliance and Sales Practices Newsletter" were reviewed. The articles are designed to train agents on company practices and procedures. Articles ranged from "Client File Documentation" to "Taking Applications Through The Mail". In the article "Taking Applications Through The Mail", for example, the Company outlines their rules concerning when applications may and may not be taken through the mail. The article states that the agent may only take an application through the mail if it is someone from whom the agent personally took a prior, in-person application, who has moved to a distant location. The article states that this can be done only if the agent is licensed in the client's new state before the application is taken. (Volume 1, Number 3, July 1995.) Other articles dealt with complaint resolution, misleading words and phrases, and errors and omissions.

STANDARD 7 – Training materials for both new and existing agents in use during the examination period comply WAC 284-23-010 through WAC 284-23-130.

Total Number of Training Materials	668
Pieces reviewed	47
Pieces not in compliance	0
Percent not in compliance	0 (within 5% tolerance limit)

RESULT: The Company meets this standard.

Agent Contracts and Compensation

For year end 1996, the Company's national marketing force consisted of approximately 5,600 agents working in 103 independently managed general agencies. For the State of Washington, there were 376 appointed agents. The Company has eight (8) types of agent/agency contracts. These are: General Agent's Contract, District Agent's Contract, College Unit Director's Contract, Field Director's Contract, Full Time Special or Soliciting Agent's Contract, Part Time Special or Soliciting Agent's Contract, College Student Agent's Contract and Senior Agent's Contract. A review of each of these contract forms and their respective commission schedules was unremarkable for any references or inducements to replace existing coverage or any improper actions. Additionally, each had persistency bonus plans listed.

STANDARD 8 – Agent contracts and commission schedules do not contain language that encourages internal replacement.

RESULT: The Company meets this standard.

Washington Agent Oversight and Agent Disciplinary Procedures

NML has three (3) General Agents (GA) with responsibility for agent oversight in the State of Washington. The General Agents are responsible for recruiting and supervising agents as well as placing and administering NML insurance in their respective territories. They have independent contractor status with NML.

Each GA reports to a Vice President of Agency Development. The Vice President of Agency Development reports to the Senior Vice President of Agencies. The Senior Vice President of Agencies reports to an Executive Vice President, who in turn reports to the President and C.E.O.

The three (3) General Agents oversee seven (7) District Agents with responsibilities in Washington. The responsibilities of the seven (7) District Agents are similar to those of the General Agents but in more limited geographical area. The District Agents are independent contractors with their General Agent. There are five (5) Field Directors and College Unit Directors with responsibilities in Washington. They have independent contractor contracts with either the General Agent or the District Agent and are involved in recruiting agents as well as the placement and administration of NML products.

The Company's agent disciplinary procedures are carried out by the Market Conduct Division through a process called a Sanctions Continuum (SC). This process aids in the consistent application of sanctions against agents who deviate from Company policies, procedures,

applicable state laws and regulations. The SC consists of four (4) tiers of violations. These tiers and their range of sanctions are:

Tier I - This is the lowest sanction level. Examples of violations in this tier failure to properly identify oneself as an agent of NML, unresolved signature discrepancy, and more than four (4) NSF checks on an agent's own account. Some of the sanctions for violations at this level are a written instructional letter or warning, requiring the agent to complete re-training in the violated area, or a plan of enhanced field supervision.

Tier II - These are more serious than Tier I violations. They include not completing annual compliance training within the time specified, altered Company material and or use of unapproved sales material, or the agent paid the 13th month policy premium from his own funds to preserve persistency on a policy. Sanctions include a written reprimand signed by the agent acknowledging his actions, the agent and GA being summoned to Home Office for a meeting, probation with documented supervision by GA, loss of the privilege of writing non-medical applications, fine or reimbursement to home office for the cost to resolve the issue.

Tier III - This level is more severe than Tier II. Violations include inappropriate replacement, altered Company material so as to make it misleading, egregious agent error or omission, repeat violations, unresponsiveness to Home Office inquiries. Sanctions range from Tier II sanctions plus contract termination if any further violations occur or a recommendation to the GA to terminate the agent's contract.

Tier IV - This is the most severe level of violations. It includes any fraudulent act, unauthorized policy changes, or intentional misrepresentations. The only noted sanction for Tier IV is immediate recommendation to the GA to terminate the agent's contract.

The company provided information concerning two (2) disciplinary actions taken against agents in Washington during the examination period. These actions were:

Agent #38491, date of action January 14, 1992, action taken – reprimand. Nature of problem – improper criticism of Company policy. The Company changed its policy on receipt of cash premiums and the agent was overzealous in criticizing the announced change.

Agent #30557, date of action May 13, 1994, action taken – reprimand. Nature of problem – failure to comply with Company policy. The agent accepted cash from a policyholder and instead of purchasing a money order with the name of the insured as the remitter, the agent kept the cash and submitted a personal check for the premium.

It should also be noted that in the report section titled "Replacements", it appears as though Tier I sanctions were imposed against Agent #61225 for higher than average replacement activity. This was not noted in the disciplinary logs from the Company. When asked, the Company responded that "suggestions for improvement were made but there was no recommendation for

disciplinary action." The Company stated that it does "not have a separate listing of sanctions or disciplinary actions for the Sales Monitoring Report. If in reviewing the Sales Monitoring Report, the Compliance/Best Practices Department or the General Agent (GA) determine that further investigation of an agent's sales practices is needed, the case is referred to the Market Conduct Division. Any disciplinary action or sanction would arise out of the investigation process" [conducted by the Market Conduct Division].

The Company advises that there are no written guidelines provided to the GA to determine how the GA should evaluate agents. The action taken by the GA is subjective and appropriate as determined by the GA. Prior to the Sales Monitoring Report, a monthly Replacement Activity Report was used as the primary replacement monitoring tool. The Sales Monitoring Report is set up to approximate a 30% replacement level. This is approximate as many factors are considered in the decision process.

STANDARD 9 – The Company has and follows written procedures for disciplining agents and that actions are documented.

RESULT: The Company meets this standard.

Agency Licensing/Appointments

We reviewed 150 randomly selected policy files to determine if the selling agent was licensed and appointed prior to taking the application (100 life, 50 annuity). There was one (1) instance where an agent took an application without being licensed or appointed with NML.

Agent 85522 wrote one (1) life policy, number 12803710 dated 1/21/94. OIC records show that this agent was licensed for life and disability in the State of Washington from 2/8/94 until 4/7/94. The Company was not able to explain why they accepted an application from this agent prior to his being licensed in Washington. This is a violation of RCW 48.17.010. The Company's data file was then checked for any other policies written by agent 85522. No other policies were written and no other violations were noted.

The Company states that in 1996 they implemented system enhancements that precluded an unlicensed agent from selling policies prior to having all contracting and licensing requirements completed.

STANDARD 10 – Agents representing the Company have been licensed and appointed prior to soliciting applications on behalf of the Company, RCW 48.17.010.

Number of agents	376
Number reviewed	65
Violations	1
Percentage	1.5% (0% tolerance)

RESULT: The Company does not meet this standard.

A review of the Company's agent termination listing was done and compared to that on file with the State. The Company reported a total of 409 terminations during the examination period. This is consistent with the State's records. Of these 409 terminations, none were reported for cause.

STANDARD 11 – All agents that have been terminated for cause by the Company have been reported terminated to the Office of the Insurance Commissioner.

RESULT: The Company meets this standard.

Complaint Handling Procedures/Complaints

NML has a detailed and comprehensive complaint processing procedure. It is contained in the Company's "Corporate Complaint Procedures Manual 1992 – 1995" and in the revised manual dated 1996 – 1997. The process starts with the criteria for recognition of a complaint. Once recognized, a complaint record is established and entered into the Company's Case Management System. This complaint record is reviewed by the Company's Complaint Administrator (CA). The CA determines who should respond to the complaint and in what specified timeframe.

The Company's procedures state that if a reply cannot be made by the tenth working day following receipt of the complaint by the Company, an interim communication must be made to the complainant or the insurance commissioner representing the complainant. The procedures also state that all Company responses must be reviewed by a member of management prior to being sent. When the complaint has been resolved, a complaint summary form is completed by the respondent and forwarded along with the file to the Complaint Administrator for final review and any follow-up actions deemed appropriate.

STANDARD 12 – The Company has and follows written complaint handling procedures.

RESULT: The Company meets this standard.

The 1992 to 1995 Complaint Procedures did not specifically track and report trends. By utilizing a Complaint Administrator and requiring management review of all complaint responses, the Company did in effect monitor the complaints and report to management on complaint activity. There was no formal procedure for trend reports to management.

Subsequent Event: The 1997 revised Complaint Summary Form added categories for analysis and tracking purposes.

STANDARD 13 – The Company monitors complaint records for trends and has a formal procedure for reporting trends to management.

RESULT: The Company does not meet this standard.

All 57 complaint files for the examination period were requested and reviewed. Since this included both direct complaints and complaints from the OIC, we did not do a separate review of OIC complaints. Eleven of the complaints were received from the OIC. The chart below details these complaints.

TYPE OF COMPLAINT	NUMBER OF COMPLAINTS	% OF TOTAL COMPLAINTS
Poor Service From Home Office	32	56.1%
Poor Service From Agent	11	19.3%
Inability of Dividends to Pay Premium	4	7.0%
Dividend Performance	3	5.3%
Miscellaneous	3	5.3%
Replacement Forms	2	3.5%
Appropriateness of Product to Meet Client Needs	2	3.5%

After review of the above, we did not find any trends or any indication of twisting or churning of policies.

As part of their complaint investigation, the Company requires a detailed written response from the agent. Because of this, it often takes longer than 15 working days for the Company to respond to complaints. On non-OIC complaints, the Company sends an acknowledgement letter to the complainant within 15 working days. Of the 11 complaints involving the OIC, a Company response was made in an average of 13 calendar days.

STANDARD 14 – The Company responds to OIC complaints within 15 business days (WAC 284-30-650) and shows good faith in resolving the complaints within 15 business days.

Total number of Complaints	57
Total number of OIC Complaints	11
OIC Complaint files reviewed	11
Number of responses within 15 day turnaround	11
Percent outside of 15 days	0 (within 5% tolerance limit)

RESULT: The Company meets this standard.

Replacement Practices

The Company provided their replacement procedures in a binder entitled "Replacement Compliance Manual 1984 through 1998." Page three (3) of the manual's introduction states:

"Permanent Insurance: The replacement of existing permanent form insurance is discouraged because it is usually to the advantage of the policyholder to retain his existing insurance. Consequently, the agent should try to supplement existing insurance instead of replacing it. However, in exceptional cases, where the circumstances of the individual case are clearly in favor of replacement, a replacement may be justified. The decision in such a case rests with the policyholder after he has been fully informed about the advantages and disadvantages of the transaction."

This statement was re-stated exactly as it appeared in the Company's Circular to Agents #391 dated October 1962. After reviewing numerous Company publications, agent newsletters and procedures, there was no evidence of any practice contrary to that stated above.

Review of annuity and life policy files for compliance with replacement regulations was done as part of the review of in force policies. Samples were not pulled from the replacement register for this exam. The average percent of business whose source was replacement for all agents was 15.2%.

Of the 50 annuity applications randomly selected for review as part of the Policy Data review, 15 were found to be replacements. We used these 15 policies as our sample to review replacement practices.

TYPE OF REPLACEMENT	NUMBER OF POLICIES
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External 1035 Exchange	3
Internal Exchange of Existing Annuity	6
Rollover from Group IRA	4
Internal Exchange from Group IRA	1

For the External 1035 exchanges, our review found that the appropriate forms were completed and that the application questions were answered. One file, # 13217964 required four (4) days from receipt of the application in home office until the notification letter was mailed. This is in violation of the three (3) day requirement of WAC 284-23-455(b).

One hundred policy files were also pulled for review as part of the Policy Data section of the examination. There were 11 of these that involved replacement. These 11 policies were

reviewed to determine company compliance with their replacement procedures and compliance with Washington Replacement Regulations.

Of the 11 replacement files reviewed, nine (9) were external replacement files and two (2) were internal replacement files. The external replacement files contained the appropriate replacement forms and the application replacement questions were answered correctly. The files also had notification letters to the existing company. Two (2) of the nine (9) files were in violation of WAC 284-23-455(2)(b) which requires the notification letter be sent within three (3) days of receipt of the application in the home office. These two (2) files are: 13208917 (6 working days) and 12638370 (5 working days). The internal replacement files also had the appropriate forms.

There were two (2) files that contained replacement forms that were dated after the date of the application. This is in violation of WAC 284-23-440(2)(a).

- Policy 12638370, the application was dated 7/15/93 and the replacement forms were dated 8/7/93, this is a violation of WAC 284-23-440(2)(a).
- Policy 13280164, the application was dated 3/21/95 and the replacement forms were dated 4/10/95, this is a violation of WAC 284-23-440(2)(a).

The Company has detailed replacement procedures. These procedures were in use in the home office during the exam period and were distributed to the field. Based upon the files reviewed, with the two (2) exceptions noted above, the Company accepts and processes applications based upon these procedures.

STANDARD 15 – The Company’s replacement procedures are in writing and are consistent with the Washington Replacement Regulations.

Total policy files	150
Policy files with replacement	26
Replacement files reviewed	26
Files in violation	4
WAC 284-23-455(2)(b)	2
WAC 284-23-440(2)(A)	2
Percent of files in violation	15%

Note: Because the sample size was small, we were unable to determine actual compliance for this standard.

RESULT: The Company meets this standard.

There are numerous agents whose average number of replacement applications exceeds the standard of less than one (1) replacement application per month. The Company does monitor replacement activity by agent within the general agency. A Monthly Replacement Activity List

consisting of two reports is sent to the GA. One report shows those policies resulting from internal replacements and the other report shows policies resulting from external replacements.

Since 1995 the Company provides the general agent with Sales Monitoring Reports twice a year. These reports indicate agents that have a higher percentage of certain types of transactions than other similar agents. The reports monitor the following categories: Replacements (both internal and external), Lower Than Minimum ISA Accounts, 13 Month Lapses, and Sales That May Have Used Inforce Policy Values. For report and tracking purposes, the Company segregates Internal Replacements from Sales That May Have Used In Force Policy Values. As defined in the Sales Monitoring Report, Internal Replacements are those replacements where the old policy has been terminated. Sales That May Have Used In Force Policy Values are those where the old policy remains in force, but values have been taken out of it.

The Sales Monitoring Report is a report by exception. The Company states that an agent appearing on the report "does not necessarily mean that the policy transactions were not appropriate, but only means that the agent had a higher percentage of the monitored activity than his/her peer group." The agent’s peer group is those agents with the same years of experience and production levels. On this same report, for comparison purposes, the GA is also rated against his peers in the Company on the same criteria as noted above

for the agents. The GA's comparison also notes the Company average and his GA Class average.

For each agent on the report, the General Agent is required to review each client file, determine if the transaction was appropriate and in the best interest of the client. They must also document their findings and return the report to the Company's Home Office for review. As part of the exam process, these reports and the General Agent's notes were reviewed for 1995 and 1996 for Washington agents.

For the time period of July through December 1996, agent #61225 had seven (7) of 18 (38.89%) of his applications originating in internal replacements. The Company average for similar agents was 4.11%. Therefore, this agent's replacement activity was 9.46 times the relative average. This agent had appeared on two (2) previous reports with numbers outside of Company averages. Additionally, of his 18 sales, four (4) or 19.05% may have used in force policy values, where the Company average for similar agents was 3.87%.

The number of policies this agent wrote during the exam period was extracted from the policy data provided by the Company. Agent #61225 sold 261 contracts during the exam period, 64 of which were replacements.

Because the GA's responses to the Sales Monitoring Report did not indicate that there were any issues surrounding this replacement activity, we asked the Company to comment on this. Compliance advises that the general agent reviewed the files and while "no specific sales

process irregularities" were noted, the general agent did "provide additional guidance to the agent." This guidance consisted of:

- institution of an internal review of the agent's replacement applications
- requiring documentation of why the existing coverage no longer met the client's needs,
- requiring the primary reason for the proposed replacement,
- determining what alternatives were discussed,
- determining whether a 1035 exchange is planned,
- discussing whether any possible exposure existed for lapse of coverage during the replacement process.

These actions appear to be part of a Tier I agent discipline sanction, but were not reported as such by the Company under the Agent Disciplinary Actions section of this examination.

Using the data files provided by the Company, data was extracted which compared the total number of contracts an agent had written during the exam period with the number of replacements he had written in this same time frame. There were 11 agents who had replacement activity which was more than 20% of their total application count during the exam period. It does not appear that the Company reprimanded or reviewed records on any except agent #61225. When asked for an explanation the Company responded that agent #62900 did not appear on the 12/96 Sales Monitoring Report due to the termination of his contract on 10/31/95. Agents 58580 and 84096 did not appear as the level of their sales activity for the period monitored did not deviate enough from the reporting criteria. See Appendix A for a listing of agents whose replacement business accounted for more than 20% of their business.

Prior to and concurrent with the Sales Monitoring Report, a Monthly Replacement Activity List by GA was maintained and provided to field management. The report included the agents name and number, the insured's name and policy number, the plan, the face amount, the name of the company being replaced and the application date. Per the Company, it was "designed to simply alert Field Management about any replacement activity being processed by any agent in their general agency."

STANDARD 16 – Number of replacements for any one agent in any calendar year should not be significant (<1 per month, combined internal and external replacements).

RESULTS: The Company does not meet this standard.

STANDARD 17 – The Company has identified patterns of replacements by individual agents such as moving policies in and out of the Company at regular intervals, replacement of large blocks of business, moving funds from one policy to another.

RESULTS: The Company meets this standard.

Policy File Review

The number of Washington policies in force as of 12/31/96 was 70,396 life and 2,579 annuities. The total number of life policies issued in Washington from 1/1/92 to 12/31/96 was 23,864 and there were 1,046 annuities issued. There were 150 (100 life, 50 annuity) policy files randomly selected for review. The policy files were reviewed with emphasis on the following areas:

- Was the application properly signed by both the applicant/owner and agent?

- Was the agent appointed by the Company and licensed by the state when the application was signed?
- Was replacement of an existing contract involved and if so were the proper replacement forms completed?
- If an external replacement, was proper notification provided to the existing company?
- Were existing policy values used to pay the premium on the new policy?

Fifty annuity files were chosen at random for review from the Company data base containing annuities written in the State of Washington during the exam. There did not appear to be any inappropriate handling of the annuity applications. There were six (6) internal exchanges of existing annuities to a new annuity. Paperwork on all six (6) appeared to be in order. By the nature of an annuity, values were rolled to the new policy.

The 100 randomly selected life files requested were matched against the Company's data file for any related policies. There were 112 additional policies that matched to the initial 100 selected. Policy records for the 112 were also reviewed.

Of the original 100 life policy files reviewed, four (4) had policy loans outstanding, one (1) of the related 112 files had a loan outstanding. Of the 212 life file total, 11 had loans which dated prior to the exam period. There did not appear to be any unusual loan activity on the reviewed policy files.

Policy Status	Reasons for Termination
Active 149	Lapse to no value 13
Active with loans 16	Surrendered 3
Terminated 47	Not Taken 7
	Terminated – Conversion 6
	Terminated – Term Upgrade 18
TOTAL 212	TOTAL 47

The review of policy records did not indicate the use of old policies being used to fund new policies. The remaining specific findings of the examination are incorporated into the sections of this report entitled Replacement Practices and Agency Licensing/Appointments.

Disciplinary Actions by Other States

There were no adverse actions taken against the Company in the five (5) years preceding this examination.

Summary

Northwestern Mutual Life has extensive training and procedural resources and it generally would appear the Company utilizes them effectively. The procedures are well documented and chronicled with an indexed CD and no apparent times lapses regarding consistent procedures were noted. While the Company has a detailed Sales Monitoring Report, numerous agents have replacement percentages in excess of 20% of submitted business, yet they do not appear on the report. When an agent did appear on the report and it was deemed necessary to provide the agent with additional guidance and oversight approximating Tier I sanctions, the agent did not appear on the Disciplinary Report.

The Company is encouraged to remain diligent in the development of its procedures and cautioned that merely having the procedures developed and in place is no guarantee that they will be uniformly followed nor have the intended impact. Consistent with this, the procedures should be continuously monitored to make certain they are providing the desired control and reporting the appropriate results.

Instructions

1. The Company is in violation of RCW 48.17.060 and is instructed to make certain all agents are licensed with the State of Washington prior to soliciting applications on behalf of the Company. (Page 13).
 2. The Company is in violation of 284-23-440(2)(a) and is instructed to require replacement forms be completed at the time the application is taken. (Page 16).
 3. The Company is in violation of WAC 284-23-455(b) and is instructed to send the replacement notification to the existing insurer with three (3) working days of receipt of the application in the home office. (Page 16)
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Recommendations

1. It is recommended that the Company more closely monitor and provide guidance to some of its agents who have demonstrated a propensity to base a significant source of their business in replacement.
 2. It is recommended that the Company facilitate intradepartmental communication so that all departments have a complete picture as to all facets of an agents performance.
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APPENDIX A

AGENTS WITH REPLACEMENTS > 20%
OF BUSINESS WRITTEN DURING
THE EXAM PERIOD

Agent #	Contracts Issued	Replacements	Percentage
26755	264	78	29.5%
47362	356	106	29.8%
53633	174	44	25.3%
58580	92	43	46.7%
60664	345	77	22.3%
61225	261	64	24.5%
62900	54	49	90.7%
63375	226	49	21.7%
64156	188	46	24.5%
84096	200	67	33.5%
85385	226	48	21.2%